No. 15,447

In the United States Court of Appeals for the Ninth Circuit

GRACE M. POWELL, EXECUTRIX OF THE ESTATE OF O. E. POWELL, DECEASED, APPELLANT

v.

RALPH C. GRANQUIST, DISTRICT DIRECTOR OF INTERNAL REVENUE, APPELLEE

On Appeal from the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLEE

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,

DAVIS W. MORTON,
Attorney,
Department of Justice,
Washintgon 25, D. C.

CLARENCE E. LUCKEY,
United States Attorney.

INDEX

CITATIONS

Cases:

Statutes:

Statutes—Continued

In the United States Court of Appeals for the Ninth Circuit

No. 15,447

GRACE M. POWELL, EXECUTRIX OF THE ESTATE OF O. E. POWELL, DECEASED, APPELLANT

v.

RALPH C. GRANQUIST, DISTRICT DIRECTOR OF INTERNAL REVENUE, APPELLEE

On Appeal from the Judgment of the United States District Court for the District of Oregon

---

BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion (R. 77-84) of the District Court is reported at 149 F. Supp. 308. The District Court's findings of fact (R. 84-87) and conclusions of law (R. 87-88) are not officially reported.

JURISDICTION

This appeal involves 50% civil fraud penalties in the amount of $12,880.39 assessed against Ora E. Powell for the years 1937 through and including 1945 in addition to deficiencies assessed against him for the same years in the amount of $25,760.74. (R.

85). The assessed deficiencies are conceded by appellant to be correct (R. 85); the fraud penalties, which were not conceded (R. 84-85), represent the only amount here in issue (R. 162-163). All of the amounts here in controversy, as well as the assessed deficiencies, interest, 25% penalties for willful failure to file returns, 10% penalties for failure to file declarations of estimated tax, and 6% penalties for substantial understatement of estimated tax (R. 22, 68, 84-84), were paid by the appellant and/or Ora E. Powell (R. 70). On July 13, 1954, Ora E. Powell filed claims for refund for the total amount (R. 68) paid (R. 70), which were disallowed, in full (R. 70). Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on December 15, 1954, appellant brought an action in the District Court for recovery of the amounts paid. (R. 3-57.) At the trial below, the deficiencies, 25% penalties, and 10% penalties were conceded, with only the 50% civil fraud penalties, and 6% penalties for substantial underestimate of estimated tax being timely put in issue. (R. 84-85.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1340. The judgment of the District Court[1] was

---

[1] The District Court below decided the 50% civil fraud issue in favor of the Director (Conclusion 4, R. 87-88) and decided the 6% penalty issue for substantial underestimates of estimated tax in favor of the taxpayer (Conclusions 5, 6, R. 88), granting judgment therefor in the amount of $1,200.55, plus interest (R. 89). No appeal has been taken by the District Director with respect to the 6% penalty issue and, accordingly, the 50% civil fraud penalty issue is the only issue here on appeal.

entered on December 21, 1956. (R. 89). Within sixty days, on or about January 9, 1957, notice of appeal was filed by taxpayer's executrix. (R. 90.) The jurisdiction of this Court is invoked under the provisions of 28 U.S.C., Section 1291.

QUESTION PRESENTED

Did the District Court err in finding and concluding that Ora E. Powell's failure to file any federal income tax returns for the years 1937 through 1945 was knowing, willful, intentional, and due to fraud with intent to evade tax, within the meaning of Section 293 (b) of the Internal Revenue Code of 1939? [2]

STATUTES INVOLVED

The pertinent statutes involved are set forth in the Appendix, *infra.*

STATEMENT

The pertinent facts, as agreed (R. 67-70), as found by the District Court (R. 84-87), and, as set forth in the District Court's opinion (R. 77-82), appear, as follows:

The taxpayer, Ora E. Powell, was, throughout the taxable years 1937 through 1945 and until his death

---

[2] Section 293(b) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, and Section 293(b) of the Revenue Act of 1938, c. 289, 52 Stat. 447, are identical to Section 293(b) of the Internal Revenue Code of 1939. For purposes of simplicity, the question is keyed to the 1939 Code provision, although the equivalent provisions of the earlier Revenue Acts apply with equal force to the years 1937 and 1938, here before the Court of appeal.

on or about July 16, 1954, a citizen and resident of Multnomah County, State of Oregon. (R. 67.) Grace M. Powell, the appellant herein, is the duly appointed qualified executrix of taxpayer's estate. (R. 84.)

The taxpayer did not file any federal income tax returns for the years 1937 through 1945 and also failed to file declarations of estimated tax for the years 1943 through 1945. (R. 77, 85.) At the beginning of this period, however, on May 10, 1937, he filed delinquent federal income tax returns for the taxable years 1933 to 1936, inclusive, with the then Collector of Internal Revenue for the District of Oregon (R. 69). During the taxable years 1937 through 1945, inclusive (for which no federal income tax returns were filed), taxpayer, in each year, had taxable income in amounts [3] giving rise to agreed total deficiency assessments and penalties in the following amounts, with only the 50% civil fraud penalties being contested for purposes of this appeal (R. 68, 85):

---

[3] Witness Daniel S. Forsberg, the Internal Revenue Agent who made the original investigation of Ora E. Powell's taxable years 1937 through 1949, testified (R. 117) that the total amount of taxable income computed for such years was "In excess of $118,000.00." Taxpayer protested this finding (R. 118, 129-130) and on re-examination, the agreed amount of total taxable income giving rise to the total agreed deficiency of $25,760.74 was developed. Because expenses were allowed in additional amounts this re-computed total agreed taxable income was somewhat lower than the original amount computed but the record does not indicate the exact amount. (See testimony of the Director's witness Edward A. Maier, R. 132.)

Year	Conceded Deficiencies In Income Tax	Conceded 25% Penalties for Wilful Failure to File Income Tax Returns	Conceded 10% Penalties for Failure to File Declarations of Estimated Tax	Contested 50% Civil Fraud Penalties, Assessed Under Section 293(b) of the 1939 Code, Which Are Here In Issue
1937	$ 100.99	$ 25.25	------	$ 50.50
1938	102.10	25.23	------	51.05
1939	76.82	19.21	------	38.41
1940	590.16	147.54	------	295.08
1941	1,027.81	256.95	------	513.91
1942	3,853.66	963.42	------	1,926.83
1943	2,520.25	630.06	$ 252.03	1,260.13
1944	11,426.55	2,856.64	1,142.66	5,713.28
1945	6,062.40	1,515.60	606.25	3,031.20
	$25,760.74	$6,439.90	$2,000.93 [4]	$12,880.39

The failure of the taxpayer to file returns came to the attention of the Internal Revenue Service in January, 1946, whereupon an investigation was begun to determine Ora E. Powell's taxable income for the years 1937 through 1945. (R. 77.) When asked for his records, "Mr. Powell said he did not have records". (R. 81.) [5] In order to determine tax-

[4] The difference between this amount and the figure of $3,201.48 (R. 68) is the amount of $1,200.55, recovered by taxpayer under the District Court judgment below and not before this Court on appeal (R. 89).

[5] See direct testimony of Harold Parsons, Internal Revenue Agent (R. 108):

Q. Why didn't you go to Mr. Powell's records and find that information?

A. We requested records from Mr. Powell and he stated that he had not kept records of his real estate transactions.

Q. Did he state whether or not he had kept records during the period in issue, 1937 to 1945?

A. That was the only period for which we requested records, the period under investigation.

payer's income it was necessary that the Internal Revenue Agents search public records in four counties, examine Powell's sons' records, and contact real estate dealers and other parties to various business transactions of the taxpayer, including the company from which he purchased gasoline. (Finding 8, R. 86.) [6]

Q. Did he state that he did or did not keep records during that period?
A. That he did not keep records during the period we were investigating.

[6] See direct testimony of Harold Parsons, Internal Revenue Agent (R. 107-108, 108-109):

Q. What was the nature of your investigation?
A. Gathering evidence to determine the tax liability of Ora E. Powell.
Q. How did you go about determining that tax liability?
A. Among other things examined the County records of Multnomah County, Washington County, Marion County, and Clackamas County, the deed and mortgage records to determine the purchase and sale of real estate by Ora E. Powell.

* * * *

Q. How long did your investigation take?
A. From June of '46 to October of '47, probably during that time we would spend between thirty and forty working days.
Q. Did Mr. Powell ever make any documents or information available to you?
A. There were some real estate sales on contract, and when we would discover such sales we would request that he bring in the contracts so that we could determine the amount of payments on the contract and the interest. When he was specifically asked for a certain contract he would bring it in.
Q. Aside from the contracts specifically requested one at a time, was there any documents or information made available to you by Mr. Powell?
A. No, not to me.

During the years 1937 to 1945, taxpayer owned and operated a number of gasoline service stations, later leasing them to his two sons, Lee G. Powell and Vincent O. Powell, receiving from them rental income. In addition, taxpayer had, at various times during the period, 19 different properties that he rented, and also, during that time, had made in excess of 30 real estate sales of farms and residences, receiving interest income on contracts and commissions from realty sales. (R. 77.)

Whereas the records taxpayer kept were adequate for him to carry on his business profitably (R. 81), he did not keep books and records adequate to show his income during the years 1937 through 1945 (Finding 8, R. 86). He never volunteered any records, information or contracts. It was only as various transactions were discovered by the Internal Revenue Agents and specific requests were made for all records and documents pertinent thereto that they were made available by the taxpayer. (R. 81.) [7]

---

[7] See direct testimony of Daniel S. Forsberg, Internal Revenue Agent (R. 114-115):

Q. Now, on the occasion of your first contact with Mr. Powell, your first personal contact, what did he say and what did you say?

A. Mr. Powell came in after the filing period in March —he had been out of State—he didn't have his copies of returns with him and he advised me at that time that he had not filed income tax returns since 1936.

Q. Did you request Mr. Powell to furnish you with any records?

A. My next question then was to furnish me with the books and records by which I might determine whether he had a tax liability or not.

Q. Did Mr. Powell produce such books and records?

He gave evasive answers to the Internal Revenue Agents who were attempting to ascertain his taxable income for the years 1937 through 1945 and did not co-operate with the agents in their investigation. (Finding 10, R. 87.)

Taxpayer was aware of his obligation to file federal income tax returns, having filed such returns for years prior to 1937.[8] He was advised by an employee of the Oregon State Tax Commission[9] and by

---

A. He advised me that he had never kept any books or records during that period of time.
Q. What was the next step in your investigation?
A. Then I asked Mr. Powell regarding bank statements and cancelled checks. He had an account at the First State Bank of Milwaukee and at my request he produced cancelled checks and bank statements for all years in question. Checks were missing for the first half of 1937 only.

See also the direct testimony of witness Harold Parsons, set forth in footnote 6, *supra*.

[8] See testimony of Daniel S. Forsberg, Internal Revenue Agent, on cross-examination (R. 125):

Q. During the course of your investigation, did you find that Mr. Powell had filed Federal income tax returns prior to the taxable year 1937?
A. Yes.
Q. For what years?
A. Delinquent returns were received in the Collector's office in May, 1937, for the years 1933, 1934, 1935 and 1936.

[9] See testimony of Carl P. Armstrong, Portland office manager of the Oregon State Tax Commission (R. 99):

Q. Did you say anything to him [Powell] about Federal Income Tax returns?
A. Yes; upon completion of our investigation of the records that he had for the years 1935 and '36 and also '37, we indicated to him at that time that he

one of his sons [10] to file federal income tax returns. (Finding 6, R. 86.)

Taxpayer made statements to Internal Revenue Agents in 1946 and 1947 to the effect that his failure to file income tax returns was based upon his disagreement with the way the country was being run and that he did not believe in paying taxes.[11] He

---

also had a tax liability to the Federal Government. This procedure was followed in all cases of our investigation because of the method used by the State Tax Commission, which was to familiarize the taxpayer with their responsibility and also to indicate to them the responsibility they might have to the Federal Government in that respect.

[10] See direct testimony of Lee G. Powell, taxpayer's son (R. 141):

Q. During those years in question, was the subject of taxes ever discussed?

A. Yes.

Q. What statements did he make to you, during those years, concerning income taxes?

A. I knew that he wasn't paying his income tax and I asked him about it and told him that he should be paying, that it was the thing for him to do, and he said he knew it but that he didn't pay because he didn't believe in the way the Government was wasting the money.

[11] See direct testimony of Harold Parsons, Internal Revenue Agent (R. 109):

Q. Did Mr. Powell ever state to you at any time his reason for failure to file income tax returns for the years 1937 to 1945?

A. Yes.

Q. What reasons did he state?

A. On at least two occasions he made the statement that he was not in sympathy with the administration and did not like the way the Government was run and did not believe in paying income taxes.

made statements to one of his sons that the reason he did not pay taxes was that he believed the Government was wasting money.[12] (Finding 7, R. 86.) He further indicated that he was thinking of getting his things gathered together and moving out of the country—going to South America where he would not have to pay taxes. (R. 80.) [13]

On or about March 9, 1948, the United States filed an Information against Ora E. Powell pursuant to Section 145(a) of the Internal Revenue Code of 1939 asserting that for the calendar years 1944 and 1945 taxpayer wilfully, knowingly and unlawfully failed to make income tax returns and, on May 24, 1949, taxpayer entered a plea of guilty to such charge. (R. 70; Finding 9, R. 86.)

Specifically finding (No. 11, R. 87) and concluding as a matter of law (Conclusion 4, R. 87-88) that the agreed deficiencies for the years 1937

---

[12] See footnote 10, *supra.*

[13] See direct testimony of Daniel S. Forsberg, Internal Revenue Agent (R. 119-130):

Q. Did Mr. Powell ever state to you, at any time, any reason for his failure to file income tax returns for the years 1937 to 1945?

A. Yes.

Q. What was the reason he gave?

A. At least on two occasions and in the presence of the joint examining special officer, Parsons, the taxpayer said that he didn't believe in the way the Country was being run and he didn't believe in paying income taxes, and he was strongly thinking of getting his things gathered together and moving out of the country and going to South America where he didn't have to pay taxes.

through 1945 were due to fraud with intent to evade tax, within the meaning of Section 293(b) of the Internal Revenue Code of 1939, the District Court pointed out in its opinion (R. 81):

> There is no evidence in the record of alteration or concealment of bank statements, cancelled checks or real estate contracts by the taxpayer. Mr. Powell said he did not have records, and there is no evidence of these having been destroyed or falsely made. However, there was no need for him to make false records or destroy records in contemplation of an investigation by the Internal Revenue Service, when at that time the taxpayer wasn't making or filing any income tax returns. The same thing is true of concealment of assets and the other "badges of fraud" to which reference has been made. The mere fact that these acts were not apparent at the time he was failing to make returns does not mean they didn't exist.

SUMMARY OF ARGUMENT

The District Court correctly found and held that taxpayer's failure to file any federal tax returns and to pay any tax during the nine consecutive years, 1937 through 1945, was knowing, willful, intentional and "due to fraud with intent to evade tax", within the meaning of Section 293(b) of the Internal Revenue Code of 1939 (and the identical provisions of Section 293(b) of the Revenue Acts of 1936 and 1938, which apply here with equal force to the taxable years 1937 and 1938). This express finding and conclusion is compellingly supported by clear and convincing record evidence and, accordingly,

should not here be reversed as clearly erroneous. Under all the facts obtaining, the 50% civil additions to tax, amounting in total to $12,880.39, were properly assessed for the years in issue.

"If any part of any deficiency is due to fraud with intent to evade tax", Section 293(b) provides that 50% of the deficiencies shall be added thereto as a civil addition to tax. The statute is remedial in nature. In applying it, a court is not dealing with common law fraud; neither is it dealing with criminal fraud, which is specifically treated in Section 145(a) and (b) of the 1939 Code, which imposes fines and imprisonment as criminal sanctions against willful failure to pay tax (a misdemeanor) and willful attempt to evade or defeat tax (a felony). On the contrary, Section 293(b) enunciates a statutory concept of "fraud with intent to evade tax", which, unlike a penalty, involves the imposition of no criminal sanctions but, instead, provides for the assessment of a civil addition to the tax deficiency.

There is a basic and fundamental distinction which obtains between the justifiably strict and constitutionally safeguarded criminal felony test for fraud, applied in imposing fines and imprisonment under Section 145(b), and the civil test properly applicable in the assessment of additions to tax under Section 293(b), which distinction is highlighted in cases, such as this, where there has been a consistent failure to file returns and pay tax, continued over a period of years. The Supreme Court has laid down the criminal test in *Spies* v. *United States*, 317 U. S. 492, pointing out that Section 145(a), the misdemeanor

statute, expressly applies to the situation of a willful failure or omission to file returns and/or pay tax, so that its Congressional purpose of enactment would be frustrated if something more—viz., an affirmative act of fraud—were not required to warrant conviction for a felony (carrying a much higher fine and possible imprisonment for 10 years) under Section 145(b). Justification for such a strict criminal fraud test is found in our traditional aversion to imprisonment for debt and in the constitutional necessity for safeguarding individual rights and immunities in criminal cases, as well as in the distinction between the Government's burden of proving a criminal felony beyond a reasonable doubt as opposed to the burden of proving the civil addition to tax by clear and convincing evidence.

Here, the taxpayer makes no effort to refute the record evidence, which stands uncontroverted, and attempts erroneously, instead, to apply to the civil assessment of additional tax, under Section 293(b), the criminal felony test of the *Spies* case, *supra*. In addition, to *Spies*, taxpayer relies on *First Trust & Savings Bank* v. *United States*, 206 F. 2d 97 (C.A. 8th), a case in which a majority of the Eighth Circuit, we submit erroneously, invoked the *Spies* criminal felony test in a civil case, clearly distinguishable on its facts from the instant case, but involving a failure—viz., "passive omission"—to file returns and pay federal tax. In attempting to argue that the justifiably strict criminal differentiation between Section 145(b), the felony, and Section 145 (a), the misdemeanor, should be applied, on the civil

side, to Section 293(b), the 50% civil addition to tax, and Section 291(a), the 5% to 25% civil addition to tax for failure to file a return, the taxpayer, apart from the fundamental objections which obtain to make such a strained analogy inapplicable, overlooks the express statutory language of Section 291 (a), which, unlike Section 145(a), is not predicated on willful failure to pay but is limited in its applicability to the single circumstance of failure to file a return. Accordingly, under the statutory pattern, Section 293(b) is the additional civil assessment which is predicated directly on willful failure to pay taxes known to be owing. Since the proscribed failure to pay must be due to "fraud with intent to evade", and the evasion may result from either total or partial concealment from the taxing authorities of such known tax liability, it follows that a total concealment, such as here obtained, will result in a higher civil addition to tax than a partial concealment (with a return being filed which willfully understates taxable income). Section 293(b) provides for this by measuring the assessment of additional tax on the amount of the deficiency.

In the instant case, the uncontroverted evidence spread on the record furnishes more than ample clear and convincing proof to support the District Court's finding that the assessed deficiencies for the years 1937 through 1945 were knowing, willful, intentional, and due to fraud with intent to evade tax, within the meaning of Section 293(b) of the 1939 Code. Taxpayer, by his own express admissions, was aware of his responsibility to file returns for the years in

question and had, in fact, filed federal tax returns for prior years; that such failure to file was willful and knowing was both admitted by himself and evidenced by his plea of guilty to such a charge in connection witm his conviction under Section 145(a), in a separate criminal proceeding. Taxpayer's educational background, his varied business activities, successfully conducted, his activities as a real estate broker, and his admission that the assessed deficiencies were correct in amount cumulatively and compellingly evidence his awareness that he received taxable income in substantial amounts throughout the period, which he never voluntarily reported. In other words, his willful failure to file returns acknowledging his responsibility to pay taxes which he had every reason to know were due and owing on substantial amounts of total taxable income received over nine consecutive years, coupled with his concession that the deficiencies assessed therefor were correct, amounted to an admission that such deficiencies, representing evaded taxes, were due to his willful concealment or fraud. In addition, taxpayer failed to keep adequate books or records reflecting his true tax liability, persisted in giving evasive answers to the investigating officers, and was altogether uncooperative throughout their basic investigation of his business and financial affairs. Indeed, it would be difficult to designedly construct a record more replete with clear and convincing evidence of taxpayer conduct warranting a finding that assessed deficiencies were due to fraud with intent

to evade tax. In this connection, the law is clear that, for purposes of Section 293(b), the willful purpose to fraudulently evade tax may properly be inferred from any conduct calculated to mislead or conceal, including a willful failure to file any returns whatsoever under circumstances where the failure is consistent over a number of years and the amount of income, willfully omitted, is substantial.

Finally, apart from its erroneous adoption of the *Spies* criminal felony test in interpreting the applicability of Section 293(b) in a civil proceeding to assess additional tax, the Eighth Circuit majority's opinion in *First Trust & Savings Bank* v. *United States*, *supra*, is in no way here controlling. The *First Trust & Savings Bank* case is clearly distinguishable on its facts, having involved a taxpayer who had never in his life, prior to investigation, filed returns, kept records, or been aware of his obligation to file federal returns. While he had heard of the income tax, he was unaware that he had a return on his investment which represented taxable income and, accordingly, did not know that he owed any tax. When investigated, he hired an attorney and cooperated fully with the authorities. Under these circumstances, the Court's finding that he had no fraudulent intent was buttressed by the investigating officer's testimony that he had made no effort to conceal.

ARGUMENT

The District Court's Finding and Conclusion—viz., That Ora E. Powell's Failure To File Any Federal Income Tax Returns for the Years 1937 Through 1945 Was Knowing, Wilful, Intentional and Due To Fraud With Intent To Evade Tax, Within the Meaning of Section 293(b) of the Internal Revenue Code of 1939 [14]—Is Supported By Clear and Convincing Record Evidence and, Accordingly, Should Not Here Be Reversed As "Clearly Erroneous"

The single issue presented on this appeal is whether the District Court correctly held, under all the facts obtaining, that (R. 87-88) 50% civil additions to tax, in the amount of $12,880.39 (R. 85), were properly assessed against Ora E. Powell for the taxable years 1937 through 1945. We submit that they were and that the District Court was amply justified in finding (No. 11, R. 87) and concluding (Conclusion 4, R. 87-88) that Powell's failure to file any federal income tax returns for those nine consecutive years was due to fraud with intent to evade tax, within the meaning of Section 293(b) of the Internal Revenue Code of 1939 (Appendix, *infra*).

Section 293(b) of the 1939 Code provides that "If any part of any deficiency is due to fraud with

---

[14] Section 293(b) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, and Section 293(b) of the Revenue Act of 1938, c. 289, 52 Stat. 447, are identical to Section 293(b) of the Internal Revenue Code of 1939. For purposes of simplicity, reference is only made to the 1939 Code section throughout the Argument, although the equivalent provisions of the earlier Revenue Acts apply with equal force to the years 1937 and 1938.

intent to evade tax" then 50% of the deficiency shall be added thereto.

The District Court found (R. 87):

> 11. The failure of Ora E. Powell to file any federal income tax returns for the years 1937 through 1947 was knowing, willful and intentional, and was due to fraud with intent to evade tax.

In this case, the District Court, in so finding, was not dealing with common law fraud; neither was it dealing with criminal fraud, as provided for in Section 145(a) and (b) of the 1939 Code, which imposes fines and imprisonment as sanctions against wilful failure to pay tax (misdemeanor) and willful attempt to evade or defeat tax (felony). On the contrary, the District Court was dealing with the statutory concept of "fraud with intent to evade tax", which involves the imposition of no criminal sanctions but instead, unlike a penalty, amounts, instead, to the assessment of a civil addition to the tax deficiency. *Helvering* v. *Mitchell,* 303 U. S. 391, 404-405.

It is, of course, basic to our self-assessed revenue system, as outlined in the 1939 Code, that the penalties (embracing "additions to the tax") imposed by Congress to enforce the tax laws include both civil and criminal sanctions. In this connection, it has long been established that invocation of one sanction does not exclude resort to the others. *Helvering* v. *Mitchell,* 303 U. S. 391; *Spies* v. *United States,* 317 U. S. 492. While this is true, it is equally true that fundamental distinctions obtain between the prosecution

of a taxpayer for criminal fraud and the imposition of a civil addition to tax "due to fraud", which is a remedial sanction "provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud." *Helvering* v. *Mitchell*, 303 U. S. 391, 401. Thus, in distinguishing, on the criminal side, between the felony prescribed by Section 145(b) and the misdemeanor under Section 145(a), the Supreme Court, in *Spies*, *supra*, pointed out (p. 498) that:

> * * * in view of our traditional aversion to imprisonment for debt, we would not without the clearest manifestation of Congressional intent assume that mere knowing and intentional default in payment of a tax, where there had been no wilful failure to disclose the liability, is intended to constitute a criminal offense of any degree. We would expect willfulness in such a case to include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.

So viewed, the Court reversed a criminal conviction under Section 145(b), where there was no evidence before it other than that of the taxpayer's willful failure to file returns and to pay tax. In doing so, however, the Court carefully pointed out (p. 499) that "Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished * * *." Earlier, in the *Mitchell* case, *supra*, the Supreme Court, holding that a criminal

acquittal under Section 145(b) was not *res judicata* in a subsequent suit to recover Section 293(b) civil fraud additions to the tax, emphasized (pp. 397, 401-404) the fundamental distinctions between a criminal prosecution for fraud and the remedial civil fraud assessment, giving specific mention to burden of proof (pp. 397, 403); collection by distraint (pp. 401-402); and a defendant's constitutional guaranties as to determination of liability (pp. 402-403), the direction of verdicts (pp. 402-403), appeal as of right (p. 403), the right to confront witnesses (pp. 403-404) or to refuse to testify (p. 404), and immunity from double jeopardy (p. 404).

While the *Mitchell* case, *supra*, evidences the obvious fact that a criminal fraud prosecution and an administrative assessment of civil additions to tax "due to fraud with intent to evade tax" may arise out of the same facts, the pains taken by the Supreme Court to delineate the basic distinctions between criminal fraud and the remedial civil fraud assessment serve to highlight the error of taxpayer's attempt (Br. 8-11, 13-14) to import into this civil proceeding the justifiably strict and constitutionally safeguarded criminal fraud test of the *Spies* case, *supra*. As Mr. Justice Jackson pointed out in *Spies* (p. 498) the conviction for the Section 145(b) felony requires establishment of the taxpayer's "evil motive", which, in turn, requires (p. 499) evidence from which an "affirmative willful attempt may be inferred." Since the conviction is for a felony, with the burden resting on the Government to prove guilt beyond a reasonable doubt, the willful failure to pay tax, which,

in and of itself, satisfies the misdemeanor requirements of Section 145(a), cannot, standing alone, support a felony conviction, carrying a possible 10 year prison sentence, under Section 145(b).

In discussing the civil additions to tax provided in Sections 291(a) (Appendix, *infra*) and 293(b) of the 1939 Code, Mrs. Powell (Br. 8-13) erroneously attempts to apply the same comparative criminal standards of proof that the Supreme Court enunciated in *Spies*, *supra*, in differentiating between justifiable conviction for a misdemeanor, under Section 145(a, and, for a felony, under Section 145(b). Ignoring the fundamental distinctions between imposition of the criminal sanctions as opposed to the civil—viz., liability for imprisonment, the penalty concept as opposed to a mere civil addition to tax, the different burdens of proof, the necessity for safeguarding constitutional guarantees in criminal cases, etc.—Mrs. Powell relies (Br. 11-13, 15-18) on the Eighth Circuit's opinion in *First Trust & Savings Bank* v. *United States*, 206 F. 2d 97, a case in which a majority of that court, as a matter of first impression, adopted the strained analogy to *Spies*, which is here relied on by Mrs. Powell (Br. 12), and concluded (p. 101) that "affirmative commission of fraud", as opposed to "willful omission to make returns", must be proved in order to support the Section 293(b) assessment of additional tax. In would not, we believe, be unfair to say that this constitutes Mrs. Powell's entire case.

Although we believe the *First Trust & Savings Bank* case, *supra*, to be clearly distinguishable from

the instant case on its facts (as we shall demonstrate, *infra*), we submit that the criminal fraud rationale of *Spies, supra,* properly has no direct applicability or controlling force with respect to the correct interpretation here to be accorded Section 293(b). In terms of statutory requirements, the Supreme Court had before it, in *Spies*, a taxpayer's willful omission to file returns and to pay tax, which constituted the precise quantum of proof requisite to conviction of a misdemeanor, under Section 145(a). Accordingly, the Court held that to prove the felony beyond a reasonable doubt, something more—viz., some affirmative act of fraud—must be additionally proved; otherwise, there would have been no purpose in Congressional enactment of Section 145(a), which precisely treated the situation there before the Court.[15] In contrast, the civil additions to tax prescribed by Sections 291(a) and 293(b) represent remedial sanc-

---

[15] In *United States* v. *Smith,* 206 F. 2d 905 (C.A. 3d) and *United States* v. *Kafes,* 214 F. 2d 887 (C.A. 3d), certiorari denied, 348 U.S. 887, the Third Circuit was concerned with the types of so-called "affirmative acts" which will support affirmance of convictions under Section 145(b) in cases where there was a failure on the part of the defendant to file tax returns. In *Smith,* Judge Staley included (p. 909) among such "acts or fraud" the fact that "defendant and his corporations received substantial amounts of income and * * * no returns were filed." In *Kafes,* a case where the jury found (p. 891) that defendant had cooperated with the investigators, Judge Goodrich listed (p. 890) defendant's avoidance of making proper books of account and records; his failure to enter some items in the duplicate receipts books that he did finally begin to keep; and the cashing of checks without clearance through his bank account.

tions which do not necessarily overlap in the sense that (Br. 17) "willful commission", as opposed to "passive conduct", is necessary to support a trial judge's finding that deficiencies are "due to fraud with intent to evade tax." While this Court in *Ohlinger* v. *United States*, 219 F. 2d 310, 313, has held that the burden of proof is on the Government, it is clear that the Government's burden may be satisfied by clear and convincing proof. See *Hargis* v. *Goodwin*, 221 F. 2d 486, 489 (C.A. 8th); *Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th); *Helvering* v. *Mitchell*, 303 U. S. 391, 403; *Spies* v. *United States*, 317 U. S. 492, 495. Under Section 291(a) the civil addition to tax, ranging from 5% to 25%, is imposed for failure to file a return without reasonable cause; unlike Section 145(a), the statute does not address itself to failure to pay tax. Section 293(b), on the other hand, is applicable where a part of a deficiency is "due to fraud with intent to evade tax." Accordingly, the two civil sanctions are addressed to different ends. A taxpayer with sufficient taxable income to require the filing of a return might have sufficient deductions, if he filed the return, to avoid the payment of any tax whatsoever. If he willfully omitted to file such a return he would technically be in violation of Section 291(a), or he could be convicted of a misdemeanor, under Section 145(a), since the requirements of that penalty statute are similarly satisfied. But where a taxpayer willfully omits to file a return and the omission results in substantial taxable income never being brought to the attention of the taxing authorities,

as a consideration separate and apart from the Section 291(a) violation, the omission or concealment produces the direct result that tax has been evaded, with the willful purpose to omit the filing of the return serving to warrant the inference of evasion. Pointing to the basic distinction between the criminal and civil sanctions and emphasizing the dependence of our self-assessed revenue system on the rendering of true accounts by taxpayer, the Tax Court stated the proposition, as follows, in *Acker* v. *Commissioner*, 26 T.C. 107, 112:

> Such willful attempt to defeat the statute or evade tax may be inferred from any conduct calculated to mislead or conceal; and it may be found not only in a situation where one of the methods employed was to file an intentionally false return, but also where the method involved a willful failure to make any return whatever. This Court has, in a number of cases, approved the imposition of the sanction under Section 293(b), where no return was filed. See for example, *A. Raymond Jones*, 25 T.C. (Feb. 29, 1956); *Arthur M. Slavin*, 43 B.T.A. 1100, 1110; *Ollie* v. *Kessler*, 39 B.T.A. 646; *Pincus Brecher*, 27 B.T.A. 1108.

On the basis of the foregoing we submit that, as a matter of law, Mrs. Powell is in error in attempting to ignore the fundamental distinctions between the criminal and the civil sanctions and to read into Section 293(b), on the civil side, the criminal fraud test applied in *Spies v. United States*, *supra*. Proceeding to the facts here obtaining, it would be difficult to construct a more classic example of a case

presenting "clear and convincing" evidence of deficiencies which arose "due to fraud with intent to evade tax", within the meaning of Section 293(b).

The testimony adduced by the Government at the trial is uncontroverted. On brief, Mrs. Powell makes no serious attempt to refute it but rests her entire argument on the theory that (p. 17) there was no willful commission of fraudulent acts by the taxpayer; no alteration, destruction or concealment of records (p. 14); and, as a consequence, the Director had not not sustained his burden of proving fraud (pp. 7, 17). While Mrs. Powell pays lip-service (Br. 17) to the established rule that the burden of proof in civil fraud cases requires only "clear and convincing" evidence, her argument (Br. 7-18), as pointed out above, is based on the here inapplicable criminal test of the *Spies* case, as reiterated, we submit erroneously, by the Eighth Circuit majority in *First Trust & Savings Bank* v. *United States, supra.*

Contrary to Mrs. Powell's mistaken reliance on a criminal felony test for fraud, we submit that the uncontroverted evidence spread on this record is both "clear and convincing" and more than amply supports the trial judge's finding (No. 11, R. 87) that taxpayer's failure to file any federal tax returns for 1937 through 1945 was knowing, willful, intentional, and was due to fraud with intent to evade tax. It would, in fact, be difficult to contrive a factual context which could nearer approximate an express admission of the Section 293(b) violation. As the first element, taxpayer was fully aware of his responsibility to file annual federal income tax returns. In

May 1937, at the beginning of the period under review, he filed delinquent returns for the years 1933, 1934, 1935, and 1936. (R. 125.) In 1938, during the early part of the period, Carl P. Armstrong, of the Oregon State Tax Commission, pursuant to an investigation of his failure to file state tax returns advised taxpayer of his responsibility to file federal tax returns. (R. 99.) Lee G. Powell, taxpayer's son, testified on direct examination that he discussed the matter with his father and advised him to file returns and pay his federal tax. (R. 141-142.) Finally, taxpayer himself advised Revenue Agent Forsberg, in 1946, that he had not filed any federal income tax returns since 1936. (R. 114-115.)

In the second place, the taxpayer was aware throughout the period under review that he had taxable income which he was not reporting. Carl P. Armstrong, of the Oregon State Tax Commission, so advised him at the beginning of the period. (R. 99.) That such taxable income was substantial is evidenced by Revenue Agent Forsberg's computation that, in total amount, it exceeded $118,000 (R. 117), as well as by taxpayer's agreement, in the pre-trial order and at the trial that, after recomputation, it was sufficient in amount to support agreed deficiencies totaling $25,760.74. (R. 68, 85). In addition, taxpayer's many and varied business activities compel the inference that he was aware of the successful nature of his commercial affairs. He had the equivalent of a high school education. (R. 138.) Between 1921 (R. 138) and 1941 (R. 142) he built up his gasoline service stations (R. 138), from a

single station to a business comprising seven stations, and, from 1941 until his death, he leased five of these stations to his son on an income-producing basis. (R. 142-143). He acquired a real estate broker's license in 1941 or 1942. (R. 139.) [16] This permitted him to receive commissions in his own right and also by working for other real estate brokers. (R. 117.) At various times during the period, taxpayer had nineteen different properties that he rented and, during that time, he made in excess of thirty real estate sales of farms and residences. (R. 116.) He maintained a bank account with the First State Bank of Milwaukee. (R. 115.) He also maintained an account during the period with the United States National Bank. (R. 114.)

In the third place, although he was aware of his responsibility to file federal returns and knew that he had substantial taxable income during the period, taxpayer admitted that his failure to file was willful. He did so by entering a plea of guilty, on May 24, 1949, to the charge of willfully, knowingly and unlawfully failing to file federal income tax returns for the years 1944 and 1945 in violation of Section 145(a) of the Internal Revenue Code of 1939. (Finding 9, R. 86.) In addition he admitted his willful failure to file throughout the period by telling Revenue Agent Parsons (R. 109) and Revenue Agent Forsberg (R. 119-120) that he did not file federal returns because he did not believe in the

---

[16] Revenue Agent Forsberg testified that Powell acquired such a license in January, 1943. (R. 117.)

way the country was being run, did not believe in paying taxes, and was strongly thinking of moving from Oregon to South America, where he would not have to pay taxes. Lee G. Powell, taxpayer's son, confirmed the fact that taxpayer, as a strong-willed man, did not pay taxes because he did not believe in the way the Government was wasting the money. (R. 141.)

In the fourth place, as the District Court found (Findings 8, 10, R. 86, 87), taxpayer did not keep books and records adequate to show his income during the years 1937 through 1945 and, when confronted by the investigating officers with requests for record evidence of his business transactions, he gave evasive answers and did not cooperate with them in their investigation. When asked for his books and records by Revenue Agent Parsons, taxpayer stated he had not kept any records of his real estate transactions for the period 1937 through 1945. (R. 108.) When contacted by Revenue Agent Forsberg, taxpayer stated again that he kept no books or records, but, upon being questioned as to bank statements and cancelled checks, he produced the same. (R. 115.) When asked generally to produce real estate contracts or other information, taxpayer stated to Agent Forsberg that he did not have them. (R. 119.) As a result of this failure to elicit records of taxpayer's real estate transactions, Revenue Agent Parsons spent between 30 and 40 working days examining the county records of Multnomah, Washington, Marion and Clackamas Counties, examining deeds and mortgages and endeavoring to determine

the nature of taxpayer's purchase and sale transactions. (R. 107-108.) With respect to real estate sales on contract, taxpayer, when asked specifically for a particular contract, would produce it. (R. 108-109.) He did not, however, make other documents or information available when not specifically requested. (R. 108-109.) In connection with determination of taxable income for the period, Revenue Agent Forsberg testified that for the period 1937 to 1941 it was necessary to determine income from the gasoline service station business from bank deposit slips and cancelled checks; there were no other records. During the lease period, 1942-1945, it was necessary to ascertain taxpayer's rental income from examination of the books of his sons, Lee G. Powell and Vincent O. Powell, checked against the sons' income tax returns. Deeds, mortgages and contracts were examined in the four counties previously mentioned and, from the tax roles the agents contacted and interviewed various persons who had purchased or leased realty from the taxpayer. Real estate commissions were test checked against available wage slips and the commission income, in the absence of other records, was estimated. (R. 115-117.) This initial computation, which occupied Agent Forsberg for more than 27 working days and yielded taxable income for the period in excess of $118,000, was protested (R. 117-118). Former Revenue Agent Edward A. Maier testified that, after the protest, he made the re-examination, in 1950, which resulted in the final computation of taxable income used as a

basis for the agreed deficiencies of $25,760.74 for the period. (R. 85, 129-130.)

He testified that he worked with an accountant hired by taxpayer and that they reached an accord. (R. 130, 135.) He stated that one of the provisions attaching to taxpayer's plea of guilty in the criminal proceeding was that he cooperate in determining his correct tax liability for the period. (R. 130-131.) Former Agent Maier testified that the agreed deficiencies arrived at were somewhat lower than Agent Forsberg's original computation due to certain expense allowances and the computation of gasoline service station income on the basis of profit per gallon developed from actual sales of gas and oil. (R. 132-133.) Agent Maier testified that his investigation lasted "probably about a week or perhaps a day or two—not over a week." (R. 132.)

Summarizing the foregoing factual analysis, we submit that the uncontroverted evidence clearly and convincingly supports the District Court's finding that the admitted deficiencies of $25,760.74 for the taxable years 1937 through 1945 were "due to fraud with intent to evade tax" within the meaning of Section 293(b) of the 1939 Code. By express admission to both the Revenue Agents and his son, taxpayer was aware of his responsibility to file returns; by express admission and by pleading guilty in the criminal case under Section 145(a), taxpayer's failure to file was willful and knowing; by direct participation in his varied successful business activities and by express concession that the deficiencies arrived at were correct, taxpayer was aware that he

received taxable income in substantial amounts throughout the period of his willful failure to file and pay. For purposes of the civil addition to tax under Section 293(b), taxpayer's willful failure to file returns acknowledging his liability to pay taxes, which he had every reason to know were due, amounted to a concealment from the taxing authorities of the total amount of taxable income received during the nine consecutive years in issue; acknowledgment of the correctness of the deficiencies amounted to an admission that such deficiencies (amounting to a total evasion of such taxes when due) were due to such concealment. Since the concealment was willful and it produced the result proscribed by Section 293(b)—viz., in this case, complete evasion of tax in substantial amounts—these facts, in and of themselves, furnish clear and convincing proof supporting the District Court's finding of civil fraud. However, in addition, taxpayer failed to keep adequate books or records sufficient to accurately determine his tax liability for the period; he consistently gave evasive answers to the investigating officers which made it difficult to appraise the adequacy of such records as he did keep and which made it necessary to conduct an expensive and painstaking investigation to arrive at an agreed estimate of his tax liability for the years in question; at no point during the agents' original investigation can it be said that taxpayer was cooperative. From the outset, it can be fairly said that this record spells out a consistent course of action taken by the

taxpayer to willfully and knowingly evade the payment of any tax whatsoever.

As we have pointed out above, for purposes of assessing civil additions to tax under Section 293(b), there is no valid basis for invoking criminal standards of proof and differentiating a taxpayer's acts of commission or of willful omission as affirmative or passive, so long as the willfully intended result is the same—viz., the concealment from the taxing authorities of taxes rightfully due and owing. *Acker* v. *Commissioner, supra.*

In this connection, for purposes of assessment of the civil addition to tax, the only difference between complete concealment of all income received—such as was here the case—and partial concealment of income received, by filing a return and willfully omitting part of one's taxable income, is provided for in the statute by measuring the civil assessment of additional tax by the amount of the resulting deficiency. In other words, under Section 293(b), a complete willful failure to file and pay will produce a higher additional assessment than will result in the case of a willful partial concealment. In the circumstances here before the Court, the critical statutory test for determining that the deficiencies were due to fraud with intent to evade tax is met by proof that the failure to file was consistent, extending over a number of years, with taxable income in a substantial amount not being reported. This civil test for applicability of Section 293(b) was succinctly stated by Judge Staley of the Third Circuit in

Schwarzkopt v. *Commissioner*, decided July 10, 1957 (57-2 U.S.T.C., par. 9816), as follows:

> The burden of proving fraud is, of course, upon respondent. Section 1112 of the Internal Revenue Code of 1939, 26 U.S.C. 1952 ed., § 1112. Petitioner contends that respondent failed to sustain his burden. This point shall not long detain us. Even if this case were devoid of the usual indicia of fraud, the consistent failure to report substantial amounts of income over a number of years, standing alone, is effective evidence of fraudulent intent.

In discussing *Spies* v. *United States*, *supra*, we pointed out our belief that the Eighth Circuit majority erred in *First Trust & Savings Bank* v. *United States*, *supra*, in applying the criminal attempt test of Section 145(b) to Section 293(b), which provides for only a civil addition to tax. We have already demonstrated the inapplicability of the *Spies* rationale to the instant case. Our final contention rests on the proposition that, in any event, the *First Trust & Savings Bank* case is clearly distinguishable from the instant case on its facts. This is clear, beyond question.

In the *First Trust & Savings Bank* case, the taxpayer, Mr. Kraftmeyer, was an Iowa farmer who attained the age of 70 without ever having filed a federal income tax return. His testimony at the trial was uncontradicted. The Eighth Circuit majority pointed out (206 F. 2d 97, 98):

> He was in his 71st year when he gave his testimony in this case to the effect that he knew

> nothing about bookkeeping and had never kept business records and no one ever told him that he had to file an income tax return. He heard of income tax prior to 1945, but thought that he "wasn't making any income" and that "he had no income". He figured that he was paying a general county and city tax and that based on what he had invested the investment wasn't making any particular return. He did not know that he owed any tax; did not know how to figure it out or how to go about it. He never had any fraudulent intent to evade taxes.

In addition, when Mr. Kraftmeyer was called in by the Revenue Agent pursuant to the investigation, the Eighth Circuit majority pointed out (pp. 98-99) that he employed an attorney and cooperated with the investigating officers in developing a full showing of all of his financial transactions throughout the period under review. At the trial, the revenue agent who made the investigation testified (p. 99) "he made no effort to conceal."

CONCLUSION

For the reasons given above, the judgment of the District Court should be affirmed.

Respectfully submitted,

JOHN N. STULL,
Acting Assistant Attorney General.

LEE A. JACKSON,

DAVIS W. MORTON,
Attorneys,
Department of Justice,
Washintgon 25, D. C.

CLARENCE E. LUCKEY,
United States Attorney.

AUGUST, 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 291. FAILURE TO FILE RETURN.

(a) [as amended by Sec. 172(f)(4), Revenue Act of 1942, c. 619, 56 Stat. 798] In case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the law: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612(d)(1).

* * * *

(26 U.S.C. 1952 ed., Sec. 291.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

* * * *

(26 U.S.C. 1952 ed., Sec. 293.)

Sections 291 and 293(b) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, and the Revenue Act of 1938, c. 289, 52 Stat. 447, are substantially the same as the sections set out above.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1957 434917 170